Defining the Intangible Asset Valuation Assignment

BY ROBERT F. REILLY

Valuation analysts are often called upon to identify and value commercial intangible assets for ad valorem property tax purposes. The valuation analyst may receive this assignment because the intangible asset is subject to ad valorem taxation in the subject jurisdiction (along with other industrial and commercial property). Or, the valuation analyst may receive this assignment because the intangible asset is exempt from ad valorem taxation in the subject jurisdiction. This latter assignment is particularly relevant when the exempt intangible asset is included in the overall property value indication. In that situation, the valuation analyst should adjust the overall property value to exclude the exempt intangible asset value.

This article summarizes the following procedures related to defining the intangible asset valuation assignment: defining the purpose and the objective of the intangible asset valuation, selecting the appropriate standard of value, selecting the appropriate premise of value, describing the subject intangible asset, describing the subject bundle of legal rights, selecting the appropriate valuation date, and defining the valuation assignment in a client engagement letter.

The discussion focuses on these valuation assignment procedures from the perspective of a property tax valuation engagement; that is, this discussion describes an assignment in which the valuation analyst is asked to determine a defined value for an identified intangible asset as of a particular date. This discussion will not describe the generally accepted intangible asset valuation approaches, methods, and procedures. For a description of those methods and procedures, see Reilly (2009a and 2009b).

For purposes of this discussion, the term *valuation analyst* is used to describe an assessor who works for a state or local taxing authority, a taxpayer employee who is responsible for appraising the taxpayer property, or an independent appraiser retained by either the taxing authority or the taxpayer. And, for

Robert F. Reilly *is a managing director of Willamette Management Associates in Chicago, Illinois. He has been the principal analyst on more than 2,500 valuations of businesses, business interests, and intellectual properties in virtually every industry and business sector. He is a certified public accountant, accredited in business valuation and certified in financial forensics, as well as a chartered financial analyst. Robert holds a master of business administration (MBA) in finance and a bachelor of arts degree in economics, both from Columbia University in New York.*

purposes of this discussion, employer organizations are referred to as "the client."

Defining and Documenting the Valuation Engagement

Engagement documentation is an important first step in defining the intangible asset valuation assignment. Typically, this procedure is performed before any quantitative or qualitative valuation analysis is prepared; before any valuation approaches, methods, or procedures are performed; and before any data (i.e., taxpayer, industry, or economic) are analyzed. And, this documentation procedure is typically performed before the analyst conducts any valuation due diligence.

The assignment documentation procedure is intended to specify what the valuation analyst is trying to accomplish. In performing this definitional procedure, the valuation analyst answers the question: What is it that I am setting out to do? Determining the appropriate answer to this question is especially important when the analyst reaches the value synthesis and conclusion step in the intangible asset valuation. When conducting the valuation reconciliation in a property tax context, the analyst will typically answer the following questions:

1. Did I value the right thing? That is, did I analyze the correct intangible asset?
2. Did I value the right thing the right way? That is, did I apply the appropriate valuation approaches, methods, and procedures?
3. Did I reach the right valuation conclusion? That is, did I correctly apply the procedures that I performed in order to reach a reasonable and supportable value estimate?
4. Did I do what I intended to do? That is, did I perform the assignment that I set out to perform? Did I achieve the purpose and objective of the assignment?

The valuation analyst may not be able to answer this last question (and may have difficulty answering any of these questions) if the intangible asset valuation assignment was not well defined and well documented early on.

The valuation analyst typically prefers that the property tax valuation assignment be set down in writing between the analyst and the client (or the client's legal counsel). The reason is that an oral agreement between the parties can lead to a misunderstanding. With an oral agreement, both parties may have a crystal clear understanding of the intangible asset valuation assignment. Unfortunately, each party may have a different crystal clear understanding of the intangible asset valuation assignment. The differences between the various understandings (all of which are crystal clear in the mind of each party) may not become known until the intangible asset valuation is completed. Of course, by then, substantial time and resources have been invested in the analysis.

Certainly, two parties to the same written agreement can have differing interpretations of that agreement. However, the differences are usually not as great as with an oral agreement.

In certain circumstances, the client (or the client's legal counsel) may prefer to forgo written documentation of the specifics of the intangible asset valuation assignment. For example, the client's legal counsel may not want to enter into a detailed engagement letter with the valuation analyst because such a letter may need to be disclosed during the discovery process in property tax litigation. In addition, a client who assigns numerous valuations (e.g., a taxing authority) may not want to issue detailed engagement letters. This is because it is a time-consuming and expensive process to draft, review, and revise such letters. Moreover, the management of a taxpayer organization may perceive

issuing a detailed engagement letter or assignment memorandum to a valuation analyst on staff as an unnecessary bureaucratic procedure between the employer and an employee. And, sometimes, it is simply difficult to effectively document the specific intangible asset valuation assignment. This may be particularly true during the early stages of the valuation of an unusual intangible asset—or the analysis of a common intangible asset for an uncommon taxpayer. However, one of the best ways for the analyst to ensure the success of the intangible asset valuation assignment is to have the parameters of the engagement carefully defined.

The valuation analyst has to work within the client's (or the legal counsel's) administrative idiosyncrasies in the best way possible. Experienced analysts typically agree that at least minimal written documentation should be created as part of every intangible asset valuation assignment.

Defining the Intangible Asset Valuation Assignment

There are two common components to the valuation assignment definition: (1) the objective of the analysis assignment and (2) the purpose of the assignment. These two components can be described as follows:

The Objective of the Assignment

The assignment objective describes what the valuation is intended to do. The assignment objective should describe the following factors:

1. The specific intangible asset that is the subject of the valuation
2. The ownership interest (or bundle of legal rights) that is the subject of the valuation
3. The standard of value (or definition of value) being estimated
4. The "as of" valuation date.

In other words, the assignment objective describes what it is that the valuation is seeking to accomplish. An example of an analysis objective statement is: "The objective of this valuation is to estimate the fair market value as of January 1, 2012, of the computer software source code owned and operated by Upsilon Corporation in fee simple interest."

Another example of an assignment objective statement is: "The objective of this valuation is to estimate the fair value as of January 1, 2012, of the licensee's interest in the proprietary manufacturing technology that was licensed from Zeta Corporation to Eta Corporation for a 10-year term."

The Purpose of the Assignment

The assignment purpose typically describes (1) who is the audience of the valuation (i.e., the party or parties who will rely on the conclusion) and (2) what decisions (if any) will be influenced by the valuation results. The assignment purpose will typically indicate the following items:

1. Why the intangible asset valuation is being performed
2. The intended use(s) of the intangible asset valuation
3. Who is expected (and permitted to) rely on the results of the intangible asset valuation.

In other words, the assignment purpose explains why the intangible asset valuation was commissioned and what use will be made of the completed valuation. A value conclusion prepared for one purpose may not be applicable if used for a different purpose. There are many individual purposes for an intangible asset valuation in addition to property taxation. Most of these individual purposes can be grouped into one of the following categories:

1. Transaction pricing and structuring
2. Financing securitization and collateralization

3. Income, gift, and estate tax planning and compliance
4. Owner or operator information and strategic planning
5. Bankruptcy and reorganization analyses
6. Forensic analysis and dispute resolution
7. Financial accounting and public reporting
8. Regulatory compliance.

An illustrative example of a valuation assignment purpose statement is: "The purpose of this analysis is to provide Mu Corporation with an independent appraisal of the Mu trademark and trade name for its ad valorem assessment appeal and/or litigation."

Valuation analysts typically agree that both the assignment purpose and objective should be documented with the client (or the client's legal counsel) before the analyst performs the intangible asset valuation.

Selecting the Appropriate Standard of Value

One of the elements in the assignment objective statement is the identification and explanation of the standard of value to be estimated. The same intangible asset can be described by many different quantitative values depending on the standard of value being estimated. Therefore, it is important for the analyst to explain—and for the parties relying on the property tax valuation to understand—exactly what type of value is being concluded.

The term *standard of value* is often considered to be synonymous with the term *definition of value*. The standard of value—or definition of value—answers the question: What type of value is being estimated? The alternative standards of value generally answer the question: Value to whom? The answer to this last question is also relevant to the analysis because the subject intangible asset may have different values to different parties.

Fair market value (or a conceptually equivalent value) is the most common standard applicable to ad valorem taxation. Nonetheless, the valuation analyst should be aware that there are many alternative standards that may apply to an intangible asset. The following discussion describes some of the alternative standards of value that are commonly applied to intangible assets. These descriptions are presented for purposes of this discussion only. Unless specifically identified, these standards of value should be considered general descriptions which do not relate to the definitions presented in any specific regulatory authority or professional standard. For example, these definitions are not necessarily the definitions provided in the *Uniform Standards of Professional Appraisal Practice* (USPAP) (Appraisal Foundation 2010).

Fair Market Value

The concept of fair market value is generally understood as the price that a hypothetical willing buyer will pay to a hypothetical willing seller with neither being under undue influence to transact. There is, however, no single definition of fair market value that is applicable for all valuation purposes. In fact, similar, but slightly varied, definitions of fair market value are provided by various statutory authority, judicial precedent, and administrative rulings. Some of these authorities expand on the definition of fair market value to include other considerations, for example, that both the buyer and the seller are cognizant of all relevant facts and circumstances or that both the buyer and the seller are seeking their maximum economic self-interests. In any event, all of the definitions of fair market value incorporate the concept of the hypothetical and unspecified willing buyer and the hypothetical and unspecified willing seller.

The fair market value standard is often applied in a regulatory, property tax, or forensic analysis context. However, this standard of value may have little empirical relevance in the real world of intangible asset sale or license transactions. The reason is that in actual intangible asset sale or license transactions, the transaction participants do not much care what the hypothetical seller will accept or what the hypothetical buyer will pay. In the real world, a specific buyer consummates a sale, license, or other transfer transaction with a specific seller. Such a transaction is typically influenced by the parties' unique interests and criteria. These unique transactional circumstances may be a departure from the hypothetical buyer/hypothetical seller construct.

Fair Value

There are two different sets of definitions for the fair value standard of value. The first definition typically is used in a forensic analysis setting. That is, this definition often applies when an owner or operator is involuntarily deprived of the use, ownership, or value of the intangible asset. Such deprivation situations typically relate to shareholder oppression actions, dissenting shareholder appraisal rights actions, condemnation and eminent domain actions, infringement claims, and the like.

The second definition typically applies in a financial accounting context. The Financial Accounting Standards Board (FASB) determines the definition of fair value for the generally accepted accounting principles (GAAP) used for financial accounting and disclosure purposes.

FASB defines fair value in *Accounting Standards Codification* (ASC) *820* (FASB 2011a) as: "The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (ASC 820-10-35-2). This fair value standard also is appropriate to the valuation of intangible assets for business combinations accounting purposes (see ASC 805-20-30 [FASB 2010]). This definition is considered appropriate as well for the periodic impairment testing of goodwill and other intangible assets (see ASC 350 [FASB 2011b]).

In the forensic analysis context, fair value may be considered as the amount that will fairly compensate the owner or operator who is involuntarily deprived of the economic enjoyment of an intangible asset in situations where there is neither a willing buyer nor a willing seller. This fair value standard is primarily a legal concept. Accordingly, there are numerous definitions of fair value that are appropriate to different types of contract tort claims, particular jurisdictional statutes, and specific judicial precedent.

One concept common to most forensic analysis definitions is that fair value is intended to estimate a fair or reasonable or equitable amount. That is, the fair value is intended to make the damaged party "whole" from an economic perspective. This fair value standard does not necessarily reflect a likely market transaction price for the intangible asset. That is because the owner or operator of the intangible asset did not initiate a market transaction. That is, the owner or operator did not attempt to put the intangible asset up for sale in the commercial marketplace. Rather, this fair value standard is most often applied in involuntary transactions. Examples of such involuntary transactions include torts for infringements, eminent domain and condemnations, expropriations, and the like.

Market Value

The market value standard is considered the most probable (or the most likely) price that an intangible asset would bring in a competitive and open market under all conditions requisite to a fair sale, including the condition that the buyer and seller are each acting prudently and

knowledgeably, and assuming the price is not affected by undue stimulus.

While the forensic analysis standard of fair value does not always concern itself with the market, market value does not concern itself with fairness. That is, market prices are not always fair to all parties involved in a sale or license transaction. Nonetheless, market value is often the best estimate of the most likely price to be obtained in an intangible asset sale or license transaction.

Acquisition Value

The acquisition value is the price that a specifically identified buyer would be expected to pay for an intangible asset with consideration given to any unique economic benefits of the intangible asset to the identified buyer. Acquisition value is typically estimated in terms of answering the question: What is the greatest price that an identified buyer can afford to pay for the intangible asset, given that buyer's unique set of circumstances?

Use Value

The use value is the price that a buyer would pay for an intangible asset in a specified use. That specified use may be different from the current use, the expected use, or the highest and best use of the intangible asset. Use value is typically estimated in terms of the following types of questions: What price would a buyer pay for the intangible asset if the buyer could use it only in South America? Or, how much would a buyer pay if the intangible asset owner or operator expanded its current use from the commodity chemicals industry to the consumer packaged goods industry? Or, what price would a buyer pay if the owner or operator has discontinued use of the intangible asset in the data processing services industry even though that application is clearly the highest and best use for that intangible asset?

Investment Value

The investment value (or investor value) is the price that a buyer would pay for an intangible asset given a particular defined set of individual investment criteria (e.g., a specific internal rate of return, investment holding period, or payback period). This standard of value does not necessarily contemplate a sale or license transaction for the intangible asset. This standard of value is more relevant to answering questions such as: What is the value of the subject intangible asset if it is only operated in commercial use for the next five years? Or, what is the value of the subject intangible asset if the current owner or operator requires an 18 percent after-tax, cash-on-cash internal rate of return on an investment in that type of intangible asset?

Owner Value

The owner value is the price that the current owner would pay for the intangible asset given that owner's current use of the intangible asset and current resources and capabilities for commercially exploiting that asset. This standard of value also does not necessarily contemplate a sale or license transaction for the intangible asset. The price that the intangible asset would bring in its appropriate transactional marketplace is not relevant to the analysis. Rather, this standard of value is more appropriate for management information or strategic planning purposes. The types of questions that an owner-value analysis usually answers are: What is the value of this intangible asset, given the current owner's abilities (or inabilities), given the current owner's sources of capital (or lack of sources of capital), given the current owner's commercialization plans (be they effective or ineffective), and so forth?

Insurable Value

The insurable value is defined as the amount of insurance proceeds necessary to replace the intangible asset with an intangible asset of comparable utility, functionality, and income-producing capacity. Again, this standard of value does not necessarily contemplate an

intangible asset market transaction. This standard of value is relevant to answering the common commercial question: How much insurance is needed for the owner or operator to protect the expected income generation of the intangible asset? This analysis typically is undertaken for purposes of business interruption insurance, expropriation insurance, property and casualty insurance, and so on. This analysis is relevant for an intangible asset operated directly as a royalty-income-producing asset or one used to produce income as part of a production, distribution, or other commercial process.

Collateral Value

The collateral value is the amount that a creditor would be willing to loan to a debtor owner or operator if the intangible asset was pledged as security for the loan. In other words, this standard of value answers the commercial question: How much can the owner or operator borrow against the value of the intangible asset?

The collateral value of an intangible asset is sometimes calculated by creditors as a percentage of either the fair market value or the market value. This calculation is performed because the creditor is only interested in how much the intangible asset could bring at sale if the debtor does not meet the debtor covenant obligations and the creditor must foreclose on the intangible asset collateral.

Selection Considerations

The selection of the appropriate standard of value is influenced by the purpose (i.e., the intended use) of the intangible asset valuation assignment. More often than not, the analyst is directed to estimate a specific standard of value by the client (or the client's legal counsel). Sometimes, the analyst is asked to decide what is the appropriate standard of value given (1) the known purpose of the valuation and (2) the known facts and circumstances regarding the subject intangible asset. If the analyst is not aware of the standard of value that is applicable to a property tax valuation in the subject taxing jurisdiction, the analyst should consult with the appropriate legal counsel. However, the selection of the objective of the valuation assignment (including the standard of value) is ultimately the responsibility of the valuation analyst's client.

The determination of what is the appropriate standard of value has a direct impact on the quantitative value estimate. The same intangible asset may have different *values* depending on the standard of value that is estimated. At this point, it should be remembered that the analyst only estimates the intangible asset value; the market actually determines the intangible asset value. This statement is true regardless of which intangible asset standard of value is being sought.

Selecting the Appropriate Premise of Value

The standard of value answers the question: Value to whom? While the standard of value explains *who* is assumed to participate in the transaction, it does not explain *how* the transaction is assumed to be consummated. That is, the standard of value does not explain the assumed conditions under which the parties will conduct the intangible asset sale or license transaction. That question is answered by the premise of value.

The premise of value is the assumed set of sale or license transactional circumstances under which the intangible asset will be analyzed. For example, when the fair market value standard of value contemplates a hypothetical willing buyer and a hypothetical willing seller, in what marketplace will they meet? How will the intangible asset be sold between the willing buyer and the willing seller? Under what set of circumstances will they enter into their fair market value transaction?

Certainly, the transactional marketplace affects the transaction price. Is the assumed market a wholesale market, retail market, auction market, dealer market, broker market, or some other type of market? This question implies that there can be a range of values for the same intangible asset within the same standard of value. In other words, there can be different fair market values for the same intangible asset, given the assumed market in which the willing buyer and the willing seller meet and transact. That is, there can be different fair market value conclusions, given different premises of value.

The appropriate premise of value may be selected by the client or the client's legal counsel. That is, there may be a premise of value that corresponds to the purpose of the valuation assignment. For property tax valuations, for example, the appropriate premise of value may be a function of the corresponding statutory authority, administrative rulings, or judicial precedent.

Alternatively, the appropriate premise of value may be selected based on the intangible asset's highest and best use. The intangible asset's highest and best use can be defined as the reasonably probable and appropriately supported use of the intangible asset that is legal permissible, physically possible, financially feasible, and ultimately results in the highest value. There is a specific definition of highest and best use for fair value accounting purposes that is included in ASC 820 (FASB 2011a). The definition used for GAAP is entirely consistent with the following discussion focused on fair market value.

Highest and Best Use Analysis

The intangible asset's highest and best use may be analyzed and selected using the following four criteria:

1. *Legal permissibility*. The highest and best use should be a lawful use. The selected use should comply with any applicable regulatory, licensing, fair trade, truth-in-advertising, or other legal requirements.
2. *Physical possibility*. The highest and best use should be physically possible, given the intangible asset's physical, functional, and technological attributes. An intangible asset, by its nature, is not typically subject to physical restrictions. However, the intangible asset's use may be subject to physical constraints. It is certainly possible that there are physical limitations on the use of an FCC license, a hospital certification of need (CON), an oil refinery operating permit, an environmental permit, an Army Corps of Engineers water extraction permit, a product or service distribution agreement in an extreme climate location, and so on.
3. *Financial feasibility*. The highest and best use should generate a positive rate of return on the intangible asset investment. Even though a particular use may be the *best* among several unprofitable uses (i.e., it is the least unprofitable use), it still does not qualify as the highest and best use. By definition, the highest and best use should generate a positive economic return to the intangible asset owner or operator. Otherwise, the taxpayer owner or operator simply will not operate the intangible asset.
4. *Maximum profitability*. Of all the remaining alternative uses for the intangible asset that are legally permissible, physically possible, and financially feasible, the one use that results in the greatest value is the highest and best use.

Among all reasonable, alternative uses, the use that yields the highest present value after capital charges are

considered for all relevant tangible and intangible contributory assets represents the intangible asset's highest and best use. Unless otherwise constrained by a client direction or legal instruction, the analyst will value the intangible asset at its highest and best use. This statement is true regardless of what standard of value is estimated in the valuation assignment.

Absent a client or legal counsel instruction, the determination of the intangible asset highest and best use will inform which of the alternative premises of value should be applied. These alternative premises of value—or alternative sets of assumed market conditions—can apply to any standard of value. These alternative premises of value typically apply to every standard of value that contemplates an intangible asset sale or license transaction.

Alternative Premises of Value

Virtually any type of intangible asset can be valued under these alternative premises of value:

1. *Value in continued use, as part of a going concern business enterprise.* Under this premise, the individual intangible asset is analyzed as part of a mass assemblage of assets, some of which may be tangible assets and some of which may be intangible assets. This premise of value contemplates the contributory value of the subject intangible asset both (a) to the other assets (both tangible and intangible) of a business enterprise and (b) from the other assets (both tangible and intangible) of a business enterprise. This premise assumes that the intangible asset will transact in the marketplace that encompasses the sale of going concern operating businesses.

2. *Value in place, but not in current use in the production of income.* Under this premise, the individual intangible asset is also analyzed as part of a mass assemblage of assets and as part of a going concern business enterprise. This premise assumes that the intangible asset will transact in the marketplace that encompasses the sale of nonoperating going concern businesses. A nonoperating going concern business is a business that is functional but not currently functioning. Examples of this apparent contradiction include a business that is temporarily shut down because of a labor strike or the death of the business owner, a business that is fully assembled but has not yet opened for business (e.g., a regional shopping mall that is fully leased and awaiting its grand opening), and a business that is temporarily shut down pending a sale (e.g., a chain hotel that is put up for sale after the chain opens a newer, competing property in the same city).

3. *Value in exchange, as part of an orderly disposition.* This premise of value contemplates that the intangible asset will enjoy a normal period of exposure to its appropriate secondary market. Under this premise, the individual intangible asset is not sold as part of a going concern business enterprise. Rather the individual intangible asset is sold on a piecemeal basis without the sale of any other tangible or intangible assets. That is, this premise assumes that the intangible asset will transact in the marketplace that encompasses the sale or license of discrete, individual intangible assets. This premise assumes that the seller does not have to sell the intangible asset by a specified sale date. That is, the seller can refuse to accept a buyer's offer price and can keep the intangible asset on

the market until it receives an offer that it finds acceptable.

4. *Value in exchange, as part of a voluntary liquidation.* This premise contemplates that the intangible asset will experience less than a normal exposure in its secondary market. In fact, this premise assumes that the owner or operator must sell the intangible asset on (or by) a specified sale date. On that date, the owner or operator must sell the intangible asset for the highest available price. The owner or operator cannot keep the intangible asset on the market in anticipation of a higher price. It is important to note that this premise assumes that the owner or operator voluntarily entered into this type of auction sale environment.

5. *Value in exchange, as part of an involuntary liquidation.* This premise contemplates that the intangible asset will receive less than the normal period of exposure to its appropriate secondary market. Under this premise of value, the individual intangible asset is not sold as part of a going concern business enterprise. It is sold on a piecemeal basis without any other tangible assets or intangible assets. The intangible asset also is assumed to transact in the marketplace that encompasses the auction or other rapid sale of discrete, individual intangible assets. Most importantly, this premise assumes that the owner or operator is not voluntarily entering into the sale transaction.

Virtually any intangible asset can be valued under these alternative valuation premises. As might be expected, the value conclusions reached under each premise can be different for the same intangible asset. For example, there could be several different fair market value estimates for the same intangible asset depending on which market is analyzed (i.e., depending on which premise of value is assumed).

As mentioned previously, the client (or the client's legal counsel) typically instructs the analyst as to the appropriate standard of value as an element of the valuation assignment. For property tax valuation purposes, the appropriate standard of value is typically dictated by statutory, judicial, or regulatory requirements. However, the selection of the appropriate premise of value is sometimes left to the judgment of the analyst. For a property tax valuation, if the client (or legal counsel) does not instruct the analyst as to the needed premise of value, then the analyst should select the appropriate premise based on:

1. The purpose and objective of the valuation; that is, what premise of value makes the most sense, given the stated purpose and objective of the valuation assignment.

2. The actual functional and economic status of the subject intangible asset; that is, under what premise of value is the intangible asset actually operating.

3. The highest and best use of the intangible asset; that is, what premise of value (or what marketplace) would conclude the greatest estimated value if the intangible asset was actually offered for sale.

Describing the Intangible Asset

The intangible asset description should be complete enough to clearly identify the particular intangible asset to those who are expected to rely on the valuation. The description should identify the physical, functional, technical, or economic parameters of the intangible asset. The description should be adequate to ensure that the valuation report reader clearly understands what intangible as-

set is included in the analysis and what intangible assets are not included.

The intangible asset description provides the same kind of information as the property legal description provides in a real estate appraisal. Unfortunately, in the discipline of intangible asset analysis, no system exists that is comparable to the system of metes and bounds that real estate appraisers use to describe a property subject to appraisal. With the exception of certain types of intellectual property, there is no formal, legal description for an intangible asset. Nonetheless, it is the analyst's responsibility to create a description that is as complete and unambiguous as possible. Even the most comprehensive and rigorous intangible asset analysis has limited utility if the valuation report reader cannot discern exactly what intangible asset (or what bundle of rights) is the subject of analysis.

Figure 1 presents an illustrative listing of many intangible assets. This listing is not intended to be comprehensive. It presents a summarized identification of each intangible asset. The listing does not purport to present a complete description of each intangible asset.

Describing the Bundle of Legal Rights

Another element in the valuation assignment is the identification of the specific bundle of legal rights that is the analysis subject. According to the bundle-of-rights theory, the complete intangible asset ownership, or what is called the title in fee, consists of a group of distinct legal rights. At least in theory, each individual legal right can be separated from the total bundle. And, each legal right can be conveyed by the fee owner to other parties, either in perpetuity or for a specified time. When an individual legal right is separated from the entire bundle of rights and transferred to another party, a partial ownership interest—or fractional ownership interest—is created.

Ownership of an intangible asset can be divided in various ways. Specific economic and legal interests separated from the total bundle of rights are involved in many kinds of income-producing intangible assets. Each of these separate economic and legal interests is distinct in its form and content. Licensee, licensor, and sublicensee estates are created when licenses or franchises to certain intangible asset ownership (or use) rights are conveyed from intangible asset owners to intangible asset operators.

Fractional ownership interests can be examined from many perspectives because the ownership, legal, economic, and financial aspects of an intangible asset overlap. There are often specific legal definitions of fractional ownership interests, including intangible asset fractional ownership interests. The following definitions are presented from a valuation perspective, not from a legal perspective. The valuation analyst should obtain the advice of legal counsel if a legal definition is required.

Some of the common ownership rights applicable to intangible assets are:

Fee Simple Interest

The owner of a fee simple interest possesses the total bundle of legal rights of the intangible property. The owner has absolute ownership of the subject intangible asset.

Life Interest or Estate

In a life interest, the duration of ownership of the intangible property is limited to the life of the owner (or to the life of a specific other party). In a life estate, the life tenant (i.e., the beneficiary) is entitled to the income generated by the intangible asset during that tenant's lifetime.

Term Interest or Estate

In a term interest or estate, the duration of the intangible property ownership is specified as a certain number of years, for example, 10 years. When the specified term has expired, the intangible asset ownership can be transferred to someone else.

Figure 1. Illustrative listing of intangible assets

- Advertising campaigns and programs
- Agreements
- Airport gates and landing slots
- Appraisal plant (files and records)
- Awards and judgments (legal)
- Bank customers—deposit, loan, trust, credit card, etc.
- Blueprints and technical drawings
- Book and other publication libraries
- Brand names and brand logos
- Broadcast radio and television station identification call letters
- Buy-sell agreements
- Certificates of need for healthcare institutions
- Chemical formulas and formulations
- Claims (against insurers, etc.)
- Computer software (both internally developed and externally purchased)
- Computerized databases
- Contracts and contract rights
- Cooperative (co-op) agreements
- Copyrights
- Credit information files
- Customer contracts
- Customer lists
- Customer relationships
- Décor (of themed park, restaurant, etc.)
- Designs, patterns, diagrams, schematics, technical drawings—related to either a product or a process
- Development rights—real property, intellectual property, etc.)
- Distribution networks and systems
- Distribution rights
- Diversion rights—water and other
- Docking rights—for freight and passenger ships
- Domain names
- Drilling rights—water, oil, gas, minerals, etc.
- Easements
- Employment agreements or contracts
- Engineering drawings and related technical documentation
- Environmental rights (and environment control exemptions)
- Extraction rights
- FCC licenses—related to radio, television, cellular telephone, paging, etc. bandwidths
- Favorable financing
- Favorable leases
- Film libraries
- Food flavorings and recipes
- Franchise agreements and rights (commercial)
- Franchise ordinances and rights (governmental)
- Going concern value (and immediate use value)
- Goodwill—institutional
- Goodwill—personal
- Goodwill—professional
- Goodwill—celebrity
- Government contracts
- Government (development or subsidy) programs
- Governmental registrations (and exemptions)
- Historical documents
- HMO enrollment lists
- Insurance expirations
- Insurance in force
- Joint venture agreement rights
- Know-how and associated procedural documentation
- Laboratory notebooks and laboratory test results
- Landing rights (for airlines)
- Leasehold estates
- Leasehold interests
- Licenses—professional, business, etc.
- Literary works
- Litigation awards and damage claims
- Loan portfolios
- Location value
- Management agreements and contracts
- Manual (versus automated) databases
- Manuscripts
- Marketing and promotional materials
- Masks and masters (for integrated circuits)
- Medical (and other professional) charts and records
- Mineral and mining rights
- Musical compositions
- Natural resources extraction, mining, development, etc. rights
- Newspaper morgue files
- Noncompete agreements and covenants
- Nondisclosure agreements
- Nondiversion agreements
- Nonsolicitation agreements
- Open-to-ship customer orders
- Options, warrants, grants, rights—related to securities
- Ore deposits
- Patent applications
- Patents—utility, design, plant
- Permits
- Personality contracts
- Possessory interest
- Prescription drug files
- Prizes and awards (related to professional recognition)
- Procedural ("how we do things here") manuals and related documentation
- Production backlogs
- Product designs and drawings
- Property use rights
- Proposals outstanding, related to contracts, customers, etc.
- Proprietary processes—and related technical documentation
- Proprietary products—and related technical documentation
- Proprietary technology—and related technical documentation
- Regulatory approvals (or exemptions from regulatory requirements)
- Retail shelf space
- Royalty agreements
- Service marks and service names
- Shareholder agreements
- Solicitation rights
- Subscription lists (for magazines, newspapers, services, etc.)
- Supplier contracts
- Technical and specialty libraries (books, records, drawings, etc.)
- Technical documentation
- Technology development or sharing agreements
- Title plants
- Trade secrets
- Trained and assembled workforce
- Trademarks and trade names
- Trade dress
- Training manuals and related educational materials, courses, and programs
- Use rights—air, water, land, etc.

Licensor or Franchisor Interests

Licensor or franchisor interests comprise the specific ownership rights and privileges that are retained by a licensor or a franchisor in the intangible asset license or franchise agreement. Alternatively, this bundle of rights may be construed as all of the remaining ownership privileges related to the intangible property that were not specifically transferred to the licensee or the franchisee.

Licensee or Franchisee Interests

By contrast, licensee or franchisee interests are the specific ownership rights and privileges granted to the licensee or franchisee in the intangible asset license or franchise agreement. These rights may be limited as to term, use, geography, and so forth.

Sublicensee or Subfranchisee Interests

Specific rights and privileges can be transferred by contract from the licensee to a sublicensee or from the franchisee to a subfranchisee. These sublicensee or subfranchisee rights cannot exceed the licensee's or franchisee's legal interests.

Reversionary Interests

Reversionary interests cover the rights to the intangible property's future ownership and economic enjoyment when such rights are currently enjoyed by another party. This bundle of rights typically includes all of the intangible asset ownership rights that were granted for a limited time period such as in a term interest or a life interest. These ownership rights revert to the intangible asset owner at the conclusion of the intangible asset use contract, license, franchise, term interest, or other rights transfer agreement.

Development Rights

Development rights are transferred by contract and allow the transferee to develop and commercialize the subject intangible property for the transferee's own benefit.

Exploitation Rights

Exploitation rights are transferred by contract and allow the transferee to make use of the intangible property. Exploitation rights typically are granted for the use or extraction of natural resources from mineral, water, oil and gas, or forest properties. However, exploitation rights also can be assigned as a contractual right to exploit an intellectual property (e.g., copyright, patent, or trademark).

Use Rights

Use rights or the right to enjoy, hold, occupy, or derive some manner of benefit from the subject intangible property are usually transferred or granted by contract. Like development rights and exploitation rights, use rights are usually granted for a specific term and a specific geography and are limited to certain specified industries, products, or services.

Other Fractional Ownership Interests

This last category includes any other limited interest, estate, or portion of a bundle of rights in an intangible property.

The definition and selection of the ownership and use interests in an intangible property has a direct influence on the value estimate. The client (or the client's legal counsel) should instruct the analyst which rights within the bundle of legal rights should be included in (or excluded from) the intangible asset valuation assignment.

Selecting the Appropriate Valuation Date

The value estimate should be concluded and stated "as of" a specified date. A specific date is required because an intangible asset's value can change over time due to both endogenous and exogenous factors. Accordingly, the value conclusion may only be relevant as of that certain specified date.

Depending on whether the valuation is performed for property tax rendition, as-

sessment, appeal, or litigation purposes, the valuation date may be

1. *Historical*; that is, as of a date prior to the analyst's preparation of the due diligence and quantitative analyses.

2. *Contemporaneous*; that is, as of a current date, or as of the date of the analyst's preparation of the due diligence and quantitative analyses.

3. *Prospective*; that is, as of a future date or a date that is after the analyst's preparation of the due diligence and quantitative analyses.

Prospective valuation dates always result in what is called a hypothetical value conclusion. A prospective value conclusion is hypothetical because it has considered conditions that have not yet come to pass. There are several reasons why a client (or legal counsel) would want an analyst's opinion of what an intangible asset will be worth in the future. One example is the projection of the amount of property tax expense related to a proposed construction project. The proposed construction may be an oil refinery that will include computer software, engineering drawings, operating licenses and environmental permits, station manuals and operational documentation, customer contracts, patents and trade secrets, an assembled workforce, and other intangible assets. A common example of the need for a historical date for property taxation purposes is a valuation as of the last assessment date.

The selection of the appropriate valuation date is typically a function of the assignment purpose. The as-of valuation date is disclosed in the statement of the assignment objective. The appropriate valuation date is most often determined by the purpose of the assignment; that is, the use to which the valuation will be put.

As with all the elements of the purpose and objective of the intangible asset valuation assignment, the selection of the appropriate valuation date should be agreed to by the analyst and the client (or the client's legal counsel). The client typically selects a certain valuation date because the client needs the value estimate to be as-of a certain assessment date to make it relevant to the client's taxation or appeal decision making. The annual assessment date is dictated by statutory authority or administrative rule.

Summary

This discussion summarized the procedures for defining and documenting an intangible asset valuation assignment. These procedures were discussed from the perspective of an ad valorem taxation assignment. Valuation analysts (including both appraisers working for assessment authorities and appraisers working for taxpayer corporations) are often asked to value commercial intangible assets that are either (1) subject to ad valorem taxation or (2) exempt from ad valorem taxation. In this later case, these intangible asset values may need to be subtracted from the overall property value.

This discussion summarized the following elements of the intangible asset analysis assignment: defining the assignment purpose and objective, describing the subject intangible asset, selecting the appropriate valuation date, selecting the appropriate standard of value, selecting the appropriate premise of value, and describing the subject bundle of legal rights.

The assignment definition and documentation procedure is an important component in the intangible asset valuation process. The engagement documentation procedure allows the valuation analyst and the client to understand what the valuation is intended to accomplish. As one result of this assign-

ment documentation, the analyst can examine the procedures performed and the conclusions reached after completing the assignment. The purpose of that examination is to determine whether the intangible asset valuation, in fact, accomplished what it set out to accomplish.

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